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Economic Outlook 1980

U.S. Report

Bank of America



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Bank of America forecasts a decline in United States real GNP of about 2 percent in 1980, following a modest gain of approximately 2 percent in 1979.

The U.S. economy is expected to slide into a recession by early 1980. After a peak-to-trough decline in real GNP of about 2.5 percent, the economy should begin a weak recovery in the second half of 1980.

Federal Reserve measures to control money supply growth, reduce inflation, and strengthen the dollar will probably make the recession longer and deeper than previously expected, but, in the long term, they hold the promise of bringing rampant inflation under control.

Growth in consumer spending has outpaced income gains throughout 1979, but high interest rates and record debt levels will cause consumption to flatten or decline slightly.

Reduced economic activity will cause the rate of unemployment to rise from the just under 6 percent level that prevailed through most of 1979 to about 7.5 percent in 1980.

Inflation will show little improvement, with consumer prices likely to rise about 11 to 11.5 percent in both 1979 and 1980. But by late 1980, the quarterly inflation rate should be down to the 9 percent area. The rate of increase in consumer food prices should ease to the 8 to 9 percent range following an 11 percent surge in 1979.

The possibility of major new OPEC price increases as well as supply uncertainties pose a serious threat to improving economic growth and reducing inflation.

The decline in housing will intensify due to high interest rates, debt levels, and housing prices, as well as lower income growth. An upturn in housing is expected to occur sometime in the latter part of 1980.

Declining sales will cause business investment to slacken—to a current-dollar increase of about 2 to 3 percent in 1980 following a 14 to 15 percent increase in 1979. However, large inventory liquidations and severe cut-backs in production are not anticipated.

Export growth in 1980 will slow to about 15 to 16 percent after a 24 percent rise in 1979. Import growth will also ease, increasing by about 12 percent compared to 19 percent in 1979. The U.S. trade deficit will narrow by \$2 to \$3 billion in 1980, to about \$25 to \$26 billion.

Interest rates have finally climbed above the rate of inflation—countering, somewhat, the incentive to borrow that has prevailed for some time. Interest rates will probably decline slowly due to continued monetary restraint and the rate floor created by inflation.

U.S. fiscal policy is likely to remain relatively restrained and a tax cut will probably be enacted sometime in 1980—to take effect in January 1981.

**Table 1. Selected Economic Indicators
For the U.S. Economy 1978-1980***

	1978	1979	1980
	(Percent Rate of Change)		
Real GNP	4.4%	2.2%	-2.1%
Consumer Price Index	7.7	11.2	11.0
Nominal GNP	11.4	11.2	6.7
Personal Consumption	11.6	11.4	8.6
Consumer Durables	12.0	5.5	-4.0
Plant and Equipment Investment	16.7	14.9	2.4
Residential Structures Investment	17.5	6.1	-5.7
Exports	17.8	24.2	15.2
Imports	17.1	18.8	12.1
	(Volume—millions of units)		
New Passenger Car Sales	11.3	10.6	9.3
Total Housing Starts	2.0	1.8	1.4
	(Percent of work force)		
Unemployment Rate	6.0%	5.8%	7.4%

* Bank of America estimates for 1979; forecasts for 1980.

The U.S. Economy

The Recession— Will It Ever Arrive?

Economic forecasters generally expected the U.S. economy to slide into a recession in 1979. Indeed, a 2.3 percent decline in the nation's real GNP in the second quarter of the year seemed to confirm this expectation and was widely cited as the beginning of the recession. The economy, however, refused to behave in a docile manner. Real GNP growth turned positive again in the third quarter with a surprising 3.4 percent increase.

Because of this gain, questions arose as to whether the economy remained on a path to recession or whether the strong third quarter results marked the beginning of a comeback. Some observers noted that the overall sluggish growth in the U.S. economy throughout the year had already provided some relief by dampening demand and easing plant capacity utilization. Certainly, the third quarter GNP growth indicated that the economy was stronger than had generally been thought and held out some hope that sustained growth could resume.

...Yes—Made More Emphatic By Restrictive Monetary Policy

Nevertheless, the fundamental weaknesses in the economy that contributed to slowed growth in 1979 are still present and continue to indicate a U.S. recession close at hand. Further, any lingering doubts as to whether these weaknesses are sufficient to result in a recession have been removed by the more restrictive monetary policy announced by the Federal Reserve in early October.

The action by the Federal Reserve, designed to more effectively control growth in the money supply, reduce inflation, and support the international value of the dollar, is the single most important recent development affecting the economy. The more restrictive monetary policy which the "Fed" felt compelled to adopt not only makes recession a near-certainty but also will make the recession more prolonged and more serious when it does arrive. This action reflects widespread concern that the greatest danger to the U.S. economy lies not in a recession, but, rather, in continued high inflation.

A Policy Change Compelled by Inflation

Several extremely important factors brought about the Federal Reserve's more restrictive monetary policy. First, inflation accelerated sharply in the past year and the struggle against it proved to be more difficult than expected. There are still no signs of a significant break in the inflationary spiral.

Second, the adverse effects of inflation on the economy have been intensifying and manifesting themselves in new and disturbing forms. The rampant speculation in gold and commodity markets during the summer and fall of this year was a clear reaction to accelerating expectations of inflation and represented a vote of no confidence in currency. Inflationary expectations raised total spending and played a significant role in creating the third quarter surge in GNP growth.

Third, money and credit have been growing at rates far in excess of those desired by the Federal Reserve. If unrestrained, rapid monetary growth would inevitably lead to further acceleration of inflation (see Figure 1).

Finally, all of these factors affected the foreign exchange markets. Continued downward pressure on the international value of the dollar forced U.S. and foreign central banks to intervene in foreign exchange markets to support the dollar. The primary source of weakness in the dollar was increasing apprehension in the international community

regarding the absence of any policies designed to effectively solve U.S. economic problems. To suppress the run on the dollar in November 1978, U.S. monetary authorities had promised to institute restrictive policies to reduce inflation. But since that time, neither a meaningful energy policy nor a serious anti-inflation policy was instituted. Particularly disturbing was the rapid growth of the money stock, which increased even faster than it had before the run on the dollar last year. Without prompt action by the United States, the eventual result could have been a renewed attack on the dollar and a subsequent spiral of dollar depreciation. This, in turn, would have further exacerbated U.S. inflation.

New Fed Policy Is Keyed To Level of Bank Reserves

Faced with these unpleasant realities, the monetary authorities opted for restraint. In early October, the Federal Reserve raised the discount rate, imposed additional reserve requirements on certain bank liabilities, and announced a fundamental change in the way monetary policy would henceforth be conducted. All of these changes imply higher interest rates and reduced credit availability in the near term.

In a sharp departure from previous operating procedures, the Fed will now pay more attention to controlling the growth of commercial bank reserves and the money stock, and less attention to interest rate fluctuations.

FIG. 1 INFLATION FOLLOWS MONEY SUPPLY GROWTH



In the past, the Fed controlled bank reserves indirectly by holding the Federal funds rate (the interest rate that commercial banks charge when they lend reserves through the Federal Reserve System to other banks) to a level that, it hoped, would bring about the desired rates of growth of bank reserves and money supply. Unfortunately, the Federal funds rate selected often did not produce the desired money growth rates.

Under the new approach, the Federal Reserve intends to supply a certain amount of reserves to the banking system and let the Federal funds rate move to whatever level is necessary to match the demand for and supply of these reserves. The result is likely to be greater volatility in the Federal funds rate as well as in other interest rates.

This redirection of emphasis does not commit the Federal Reserve to concentrating strictly

on reserves targeting nor imply a total abandonment of interest rate goals. The option to emphasize either approach is retained. It remains to be seen just how much interest rate volatility will occur and how much volatility the Fed is willing to tolerate. But if the Fed holds to reserve targeting as the primary means of implementing policy, it will mark a very important departure from past practices. Moreover, it may eventually allow the Fed to get a reasonably effective handle on money stock growth and to reduce inflation.

Restraint Will Be Tested As U.S. Economy Slows

To obtain lasting benefits from this new Federal Reserve policy, it must be maintained over a prolonged period. However, the Fed's resolve will be sorely tested in the months to come. High interest rates will meet with immediate opposition, and pressure will further intensify as real output declines and unemployment rises. If the Fed followed its historical pattern, it would yield to this pressure and encourage rapid money growth sometime in the first half of 1980. And that, in turn, would mean renewed inflationary pressure farther down the road.

On the other hand, the Fed has compelling reasons to maintain its new policy. If it reverses course, its credibility will be lost for many years to come, particularly in the international community. In addition, this new policy indicates a deep dissatis-

faction with the results of past policies and a firm commitment to reduce inflation. This commitment will have to be strong, for there are few short-run benefits, and many costs, in the fight against inflation.

The retarding effects of tight monetary policy on the economy may not appear immediately. Possibly, the present momentum, driven by continued strength in consumer spending, business investment, and exports, could carry the economy through the end of the year. Consequently, the principal uncertainty is whether the downturn will prove to have begun in the fourth quarter of this year or will come about in the first quarter of 1980. But at some point, no later than early next year, the recession seems bound to hit. When it does, housing demand will finally begin a serious decline, consumption demand will weaken, and business fixed investment will drop sharply. Unemployment, which was just under 6 percent for most of 1979, will increase to nearly 7.5 percent in 1980. The recession is expected to last about three quarters and the economy should begin a weak recovery in the second half of 1980.

On a full-year basis, real GNP will grow about 2 percent in 1979 and then decline around 2 percent in 1980. The decline from peak-to-trough quarters will be approximately 2.5 percent. That would make the projected recession less than half as deep as the 5.7 percent decline in 1973-75, but somewhat more severe than the average decline in the five

previous postwar recessions. In the three mildest of these (1948-49, 1960, and 1969-70), real GNP fell only a little more than 1 percent, while in the two more severe downturns (1953-54 and 1957-58), real GNP fell somewhat over 3 percent.

Consumption Outpaces Real Income Gains

Normally, the main determinant of growth in consumption is growth in disposable personal income. But during the first three quarters of 1979, real consumption expenditures rose while real disposable personal income declined. Indeed, quite uncharacteristically, the growth of consumption has outpaced that of income throughout the current economic expansion. Real consumption expenditures have grown at an average annual rate of 4.5 percent per quarter since 1975. This vigorous performance has been exceeded in only one previous postwar expansion, that of 1971-73.

It is important to isolate the source of this strength, for consumption will play a crucial role in determining the severity of the coming recession. The three major causes are: an unwillingness on the part of consumers to adjust to slow income growth; persistent inflation; and demographic forces.

Slow Income Growth

Real disposable personal income has grown slowly at an average annual rate of 4.1 percent per quarter during this economic expansion, compared with 4.7

percent in previous expansions. The source of this slower growth lies primarily in the very small productivity gains achieved in the most recent period. This low productivity growth is mirrored in reduced rates of growth in real disposable income per worker.

Overall, real income per worker has grown at an average annual rate of only 1.4 percent per quarter during this expansion, compared with 2.5 percent during previous expansions. For almost two years, real income per worker has actually been declining. At the same time, the growth of the labor force, as well as total employment, has risen from an average annual rate of 2.1 percent per quarter during previous expansions to 2.7 percent during this expansion. Even so, this rapid growth of employment could only partly offset the retarding effects that lower productivity growth exerts on total income growth.

Eventually, consumption growth will slow because it must come into line with income growth. But, so far, individuals have resisted adjusting their spending patterns to the reality of income growth.

Inflationary Psychology

The willingness to spend has been reinforced by a growing inflationary psychology. In times past, the expectation of inflation led individuals to spend less and save more, in order to afford higher prices. But of late, as expectations of inflation have risen, individuals have reacted in the opposite manner, spending more rather than less.

Such behavior is a rational response to inflation-created distortions. Inflation has raised the rate of return available on physical goods relative to the costs of borrowing and the returns available on financial assets. The purchase of housing and, to a lesser extent, other durable goods becomes a hedge against inflation, as the inflation-induced increase in their value offsets the depreciation and after-tax interest cost of owning them. This is true because nominal interest rates, though high compared to previous periods, have nonetheless been running below the inflation rate.

Real after-tax costs of borrowing have until recently remained among the lowest of the postwar period. At the same time, the relative attractiveness of owning real goods rather than financial assets has risen because returns on savings instruments have failed to keep pace with inflation. During the past two years, inflation-induced spending may have been responsible for 15 to 17 percent of housing starts and 5 to 7 percent of automobile sales.

Demographic Forces

Changes in the age distribution of the population have also influenced consumption growth. Americans born in the post-World War II baby boom are now in the 25 to 35 year age bracket. This is the age group which is historically most involved in forming households, purchasing and fur-

nishing homes, and raising families. At the other end of the age spectrum, the steady increase in the over-65 population also results in a lessening of savings relative to income.

These factors have created significant changes in spending patterns. The portion of total consumer spending allocated to purchases of durable goods rose from around 12 percent during the early 1960s to 16 percent in the past few years.

*As Consumption Grew
Faster than Income . . .*

**FIG. 2 REAL GROWTH RATE
SINCE 1975**

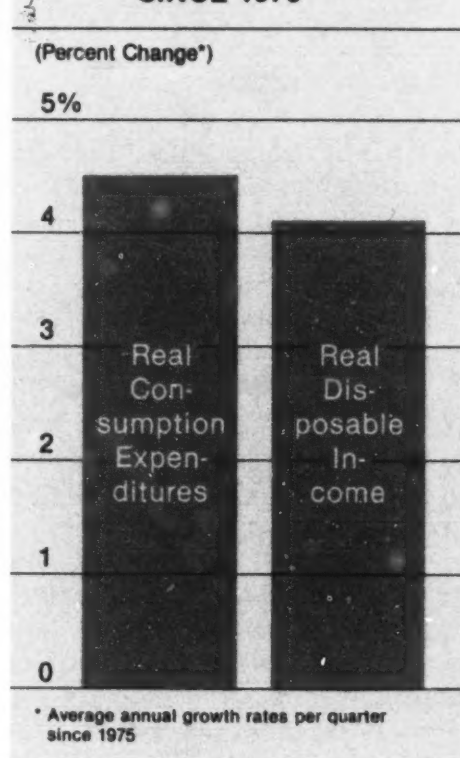
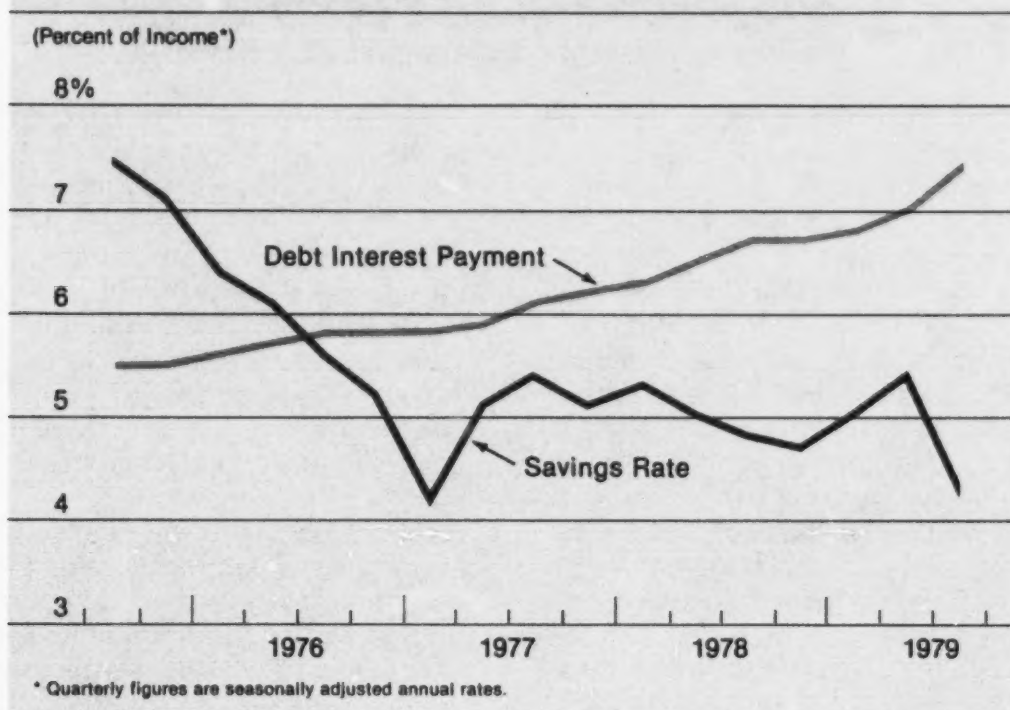


FIG. 3 PERCENT OF AVERAGE INCOME SAVED AND OF HOUSEHOLD INCOME USED FOR DEBT INTEREST



Less Real Income, High Debt Will Force Spending Decline

To this point, the strength of consumption has helped to sustain overall growth. But it has also created strains that now point toward a decline in consumption. Furthermore, the longer consumption continues to outpace income growth, the greater these strains will become and the bigger the eventual decline.

To accommodate a consumption growth greater than real income gains, consumers have decreased their savings rate and heavily increased their use of debt. In the past two years, the proportion of income saved has

averaged only 5.1 percent, compared with the historical average of 6.1 percent. During the third quarter of 1979, it dropped to only 4.3 percent. Meanwhile, consumer installment credit extensions (the flow rate of new credit) have risen from 17 percent of disposable income in early 1975 to more than 20 percent. The percentage of income required to pay interest on debt has been rising since mid-1976 and has reached a record 7.4 percent of income (see Figure 3).

However, as the economy weakens, employment and income will decline. Recent increases in nominal interest rates have finally driven them above the rate of inflation. Thus, declin-

ing real incomes combined with high debt burdens and high interest rates will force a decline in consumption. It is possible that consumers will resist the effect of declining incomes by lowering their savings even more. But given the already low level to which savings have declined, it is doubtful that the savings rate can fall much further. Moreover, the need to service the past accumulation of debt will generate "forced savings" in the form of principal and interest payments and, in so doing, will reduce the amount of discretionary income available for other expenditures.

While overall consumption will slow, we expect demographic forces and inflationary psychology to keep consumer demand relatively firm. The proportion of income consumed will decrease, but it will remain high by historical standards. Real consumption will flatten or decline slightly in 1980 following a gain of about 2.3 percent in 1979.

The downturn in housing will reduce demand for consumer durables. Accumulated stocks of automobiles and other large consumer durable goods will facilitate the deferral of business spending. Auto sales volume will be impaired by increased gasoline prices and a consumer shift to smaller, more fuel-efficient cars amidst a cutback in overall spending. High energy prices will affect a broad spectrum of purchases, including nondurables, fuel, electricity, and transportation services.

In the second half of 1980, stronger growth of real income

and some improvement in household debt burdens should lead to a recovery in overall consumption demand.

The Outlook for Housing— An Intensified Decline

In previous economic slowdowns, thrift institutions suffered an outflow of funds when market rates of interest rose above the rates these institutions were legally allowed to pay on their deposits. Thrifts were then forced to curtail their mortgage lending. The result was often a severe decline in the housing industry. In the 1973-74 downturn, for example, housing starts fell nearly 60 percent from their previous peak.

A similar decline might have been expected, as interest rates have risen to high levels in the current cycle. But a number of innovations have dramatically lessened the danger of funds outflow. Foremost is the introduction of money market certificates that allow thrifts and other depository institutions to attract savings by paying high rates on certain types of deposits.

Nevertheless, the adverse fundamentals of high interest rates, debt burdens, and housing prices, combined with weak real income growth, are taking their toll on demand. Housing starts and real expenditures for residential construction have trended generally downward since peaking more than a year ago.

The worst of the decline is still to come, for the higher interest rates accompanying the latest

Federal Reserve tightening will further reduce both the demand and supply of mortgage financing. Rising interest rates and house prices together have raised the average monthly payment on a single-family home by over 20 percent in the past year, while current-dollar personal income has risen only 11 percent. With house payment increases outpacing income growth by such a wide margin, many potential buyers are being priced out of the market.

Because of higher interest rates, some savings institutions will experience slower growth of deposits and others will experience increased disintermediation, a process that has already been in evidence for some months at mutual savings banks. The results will be reduced availability of mortgage financing.

Easing By Mid-1980

Housing starts will continue to decline for several more quarters before staging a comeback. But the underlying demand will remain strong. As inflation slows, the growth of real income will pick up and interest rates will start to ease. The flow of deposits to savings institutions should increase, adding to the availability of credit and stimulating demand. Under the combined impact of these forces, housing should begin to turn around by mid-1980.

Sales Decline Will Slow Business Investment

Business investment has been quite strong, particularly in expenditures for structures. But plans for future spending have already been pared and will be cut further once the recession takes hold and sales begin to decline. High interest rates also will have a retarding effect. Declining sales and higher unit labor costs will create a profit squeeze that will decrease liquidity and reduce the flow of internally generated funds. The consequent need to rely more on external financing sources will accentuate the effect of high interest rates on the cost of funds. Business fixed investment will grow only 2 to 3 percent in nominal terms in 1980, following a 14 to 15 percent increase in 1979.

Because a recession has been widely expected for some time, businesses have kept a tight rein on inventories. As a result, inventory imbalances are currently mild. As sales decline, however, unwanted inventories will accumulate, and it will take several quarters to dispose of this excess. But the inventory overhang, in contrast to the 1974 experience, should not become severe and no massive inventory liquidations nor severe cutbacks in production are expected.

Continued Restraint in Government Spending

U.S. fiscal policy has been relatively restrained over the past year and is likely to remain so during 1980. Real federal government expenditures will grow by only 0.5 to 1.0 percent in 1980 following less than 0.5 percent growth in 1979. The amount of income subject to Social Security tax will rise in 1980, while inflation will push many people into higher tax brackets—causing a substantial increase in government revenue.

We believe a tax cut will be enacted sometime in 1980. It will probably take effect in January 1981, timed to partly offset an increase in Social Security tax rates scheduled to begin at that time. The tax cut might be about \$25 billion, with about a \$10 billion offset, in some form, to Social Security taxes, a \$10 billion cut in personal income taxes, and about a \$5 billion easing in corporate taxes.

OPEC Prices Will Rise— Production Levels Uncertain

A significant part of U.S. economic problems stems from the large price increases imposed by OPEC during 1979. The price of Saudi Arabian crude petroleum, which serves as the benchmark price for OPEC oil, rose at annualized quarterly rates of around 100 percent in mid-1979 and will rise around 35 percent for the year as a whole.

Unfortunately, the oil shortage and price increases created by the unrest in Iran starting late last year left a legacy of OPEC militancy, which most likely means that oil prices will be linked to the world inflation rate and will change more frequently than in the past. OPEC has learned that the demand for oil is relatively price inelastic, in that the loss of revenues associated with lower production is more than offset by higher prices. As a result, oil producing countries now appear determined to force continued rapid increases in price by curtailing production. Some countries will hold output below capacity to facilitate ultimate recovery and maximize revenues. Others have limited reserves and face technical constraints on output.

The net implication is that supply and demand for petroleum will remain in precarious balance. Reduced growth in energy demands, caused by the slowdown in the U.S. and world economies, will provide little downward pressure on prices since supply growth will remain limited. Further, the dangerous tension in the Mideast threatens additional supply reductions and price increases.

Barring a severe crisis, oil prices will not go up as steeply as they did in 1979, although the rate of increase will remain high. OPEC is likely to seek real price increases of 4 to 6 percent per year. Given world inflation rates of 10 to 11 percent per year, this implies nominal price increases of 14 to 17 percent per year over the next few years.

U.S. Policies Will Affect Impact of Oil Price Increases

The detrimental effects of recent and projected oil price increases on real growth cannot be avoided. However, the impact of these oil price increases on inflation, trade balances, and the international value of the dollar depends critically on domestic fiscal, monetary, and energy policies.

Following the quadrupling of oil prices in 1973, the United States, as well as most industrialized countries, instituted expansionary policies to overcome the contractionary impact of oil price increases. The result was a massive acceleration of inflation. The consequent deterioration in the U.S. balance of payments was exacerbated by an energy policy that subsidized oil imports at the expense of domestic production. But the pressures facing the economy this time strongly suggest a response of near-term fiscal and monetary restraint here and abroad, which should prevent a repeat of the post-1973 situation. Moreover, the U.S. finally is undertaking the decontrol of domestic oil prices, which will retard the growth of energy consumption and stimulate the growth of domestic supplies.

Assuming continued fiscal and monetary restraint, the direct effect of oil price increases will be a reduction in GNP growth of about 0.5 percent in 1979 and 1.0 percent in 1980. The impact on the Consumer Price Index will be an increase of about 1.0 percent in 1980.

Inflation Prospects— Only Limited Relief

The rapid acceleration of inflation over the past two years reflected strong excess demand pressures and large increases in food and energy prices. The slack demand accompanying the recession will produce little near-term improvement, for the rate of inflation changes only slowly when demand changes. The rate of increase in the Consumer Price Index is not expected to change and will remain around 11 to 11.5 percent in 1980. The annual numbers, however, conceal an improvement. Quarterly rates of inflation should decline to about 9.0 percent by late 1980.

Rates of increase in energy prices, driven by continued deregulation of domestic oil and by natural gas prices and future OPEC price increases, will remain high but should begin to slow gradually from their 1979 levels in the latter part of 1980.

The rate of increase in consumer food prices should ease from nearly 11 percent in 1979 to the 8 to 9 percent range in 1980. Meat prices have already declined and the rate of increase should remain moderate through the first half of 1980, reflecting reduced demand and good supplies, especially of pork and poultry. World demand for U.S. crops will remain high, partly because of crop shortfalls in the Soviet Union and smaller export supplies in competing countries. But a record U.S. crop in 1979, combined with expected good production in 1980

and a drawdown in inventories, should moderate crop price increases. The result will be more modest increases at the producer level, but retail prices, sustained by continued rapid increases in labor costs, will keep rising. As the economy recovers in the second half of 1980, income gains will again raise demand and, in turn, the rate of increase in food prices.

Recent interest rate increases will keep borrowing costs high early in the year, but once they start declining, they will help to temper inflation. The effect will be particularly noticeable in the Consumer Price Index, which was driven up substantially by large increases in mortgage rates during the past year. Finally, a more stable dollar should prevent major new inflationary pressures which would arise from devaluation, and weakened demand will lower the growth rate of cyclically sensitive prices.

Pressure for Wage Adjustments Puts Floor Under Inflation Rate

Continued pressures on unit labor costs, however, will put a high floor under any decline in inflation. Rising unemployment in the weakening economy will tend to slow wage growth, but this will be offset by strong upward pressure on wages from past and anticipated inflation. While wages usually tend to keep up with

prices, for the past year and a half the rate of increase in prices has exceeded the growth of wages. In fact, real wages declined at annualized rates of over 5 percent in the two mid-quarters of 1979. This can partially be attributed to the wage guidelines, which have been particularly effective in holding down wages in the non-union sector.

The upward adjustment of wages will be facilitated by the weakening of the wage guidelines. Union contract settlements exceeded the 7 percent goal in 1979—a fact implicitly acknowledged in the recent relaxation of the guidelines to 8 percent. Non-union wages will tend to rise relatively more rapidly to close the gap with union wages.

Improved productivity is not expected to counter the consequent upward pressures on costs—especially in the near term. As the economy slows, businesses will reduce employment. But these reductions will lag behind declines in demand and output. The result will be lower productivity and, therefore, higher rates of increase in unit labor costs—rising from about 10 percent in 1979 to around 12 to 13 percent in 1980. When the economy comes out of the recession, productivity should improve and rates of growth in unit labor costs should slow. The result will be slower rates of price increase. But the full effects will not appear until 1981.

Slow Decline for Interest Rates

Interest rates, now at or near their peaks, have been held up by strong loan demand, rapid inflation, and, recently, restrictive monetary policy. Once the recession arrives, declining real output should reduce demands for money and credit and should bring about the long-awaited decline in interest rates.

This decline, however, will be slowed by continued monetary restraint and the interest rate floor created by inflation levels. Short-term interest rates are likely to decline by about 4 to 5 percentage points by the end of 1980. Longer-term rates, which were comparatively slower to adjust upward as inflation accelerated during the past year, are also likely to decline later and more slowly than short-term rates.

Trade Balance Should Show Improvement

The U.S. balance of payments accounts improved in 1979 and should continue to do so in 1980. Export growth in 1979 benefited from strong gains abroad combined with improved price competitiveness for U.S. goods, reflecting past dollar depreciation. In 1980, slowing foreign economies will reduce demand while a more stable dollar will prevent further improvement in the price competitiveness of U.S. products. Consequently, the rate of growth of exports will ease to around 15 to 16 percent in 1980 from about

24 to 25 percent in 1979. But as U.S. demand declines, the rate of import growth will also slow—to around 12 percent from nearly 19 percent in 1979. The continued greater percentage gains for exports relative to imports should lower the merchandise trade deficit by \$2 to \$3 billion to a level of \$25 to \$26 billion.

Export growth will continue to be concentrated in agricultural products and manufactured goods. Agricultural exports will benefit from the demand created by poor harvests in foreign countries and large grain sales to the Soviet Union. Chemicals and aircraft sales will continue strong.

The slower growth in imports, as measured in dollars, will not extend to oil. For although the recession will create a decrease in the unit volume of oil imports, the continued rise in oil prices will lead to a significantly larger dollar value of oil imports.

Non-oil imports are likely to increase by only 4 to 5 percent in 1980. Most of the slowing will derive from the cyclically sensitive crude and intermediate materials categories, which will respond rapidly to the recession-engendered decrease in demand.

The U.S. current account, a broader measure of the country's international transactions, will reach near balance in 1979 and swing into a surplus of \$4 to \$5 billion in 1980. The main source of improvement over the past year has been a large increase in the earnings of foreign affiliates of U.S. companies. These earnings will continue to grow in 1980, although at a slower rate.

The Challenge of the 1980s

For the United States, 1980 will be an extremely important year. It ushers in a decade in which the nation must face up to, and, it is hoped, resolve the problems of high inflation and reduced economic growth that have marked the 1970s.

Deep declines in productivity growth have contributed to rapid inflation and have lowered the potential annual growth in real GNP from its historical average of 3.5 percent to between 2.5 and 3 percent. Persistently high inflation and slow economic growth have led to a general loss of confidence, a spreading sense of malaise, and a growing struggle over income distribution.

In the midst of these present problems, there is cause for guarded optimism. The generally hostile attitude of government towards business appears to be declining and the wave of regulation seems to have crested. This should allow greater investment in productive resources rather

than diversion of capital to meet regulatory requirements. The dramatic decline in labor force growth which will occur over the next decade will lessen pressure for inflation-feeding, expansionary policies, while helping to reduce unemployment and raise productivity. Future fiscal and monetary policies are likely to encourage increased savings and investment. Furthermore, there seems to be a general realization that the nation must give top priority to halting inflation and increasing economic growth.

If successful, we stand a good chance of lowering inflation to the 6 percent range by the mid-1980s while improving our productive capacity and rate of economic growth. If not, we face a pattern of ever increasing inflation at cyclical peaks, followed by only partial relief during economic slowdowns—a pattern that has proven to be extremely harmful to economic systems wherever it has occurred.

Bank of America NT&SA, founded in 1904 by A. P. Giannini, has over 1,000 branches in 500 California communities and more than 120 branches and representative offices overseas. As of September 30, 1979, the bank's consolidated assets were more than \$102 billion.

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